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SUBJECT: PM FISCHER MEETS WITH AMCHAM AND EMBASSY

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¶1. (SBU) Summary: Prime Minister Fischer and members of the American Chamber of Commerce discussed the current investment climate in the Czech Republic at a November 23 dinner hosted by the Charge. AmCham said concerns about the lack of government stability are beginning to take a toll on investment decisions. AmCham also cited corruption and the inflexibility of Czech infrastructure providers and offered recommendations on taxation, promoting tourism, energy efficiency, euro adoption, research and development funding, and improving government transparency and efficiency. PM Fischer said it is unfortunate that a non-political, interim government such as his exists at all, given the limitations it faces in making political decisions. He complained that the current Czech electoral system produced weak coalition governments unable to enact difficult but needed reforms and suggested that changes to the electoral system may be needed. He also bemoaned the poor relations between politicians and civil servants and society's short term thinking. He announced plans to put forward a draft package of anti-corruption measures but was unsure how parliament might react. He also noted his fiscal conservatism and said he was proud that the Czech Republic had avoided both protection measures and stimulating consumption during the economic slowdown. End Summary

AmCham's Concerns

¶2. (SBU) AmCham Executive Director Weston Stacey noted that during his 18 years in the Czech Republic he has never before seen as large a disconnect between politicians and the business community as that which exists today and thanked the PM for being willing to start a dialog. AmCham had polled its members and found that there currently exists a neutral investment and job climate among international firms in the Czech Republic, a significant improvement over last year. Companies are not planning to cut jobs or leave the country. They are also, however, not planning to hire additional labor or make additional investments, thus limiting the pace of the Czech economy recovery.

¶3. (SBU) Stacey noted that AmCham members had identified three main concerns that are influencing their long-term investment plans. First, while political stability used to be a major selling point for investing in the Czech Republic, this was no longer the case. Weak governments unable to enact needed reforms as well as changes in government leading to significant changes in policy all made it very difficult for businesses to plan for the future. Second, frequent corruption scandals have created the perception that a level playing field does not exist. Third, while foreign investment in the past had been mainly for large cookie

cutter manufacturing plants, future investment is much more likely to be by smaller businesses with specialized demands on Czech infrastructure. It is not clear that the Czech authorities are able to respond quickly enough to meet these needs. For instance, the Czech Republic recently lost a major investment when neither the semi-state electricity company CEZ nor CzechInvest were flexible enough to quickly accommodate the energy needs of a potential investor.

AmCham Creates the Council for Czech Competitiveness

14. (SBU) Stacey, speaking for the group, briefed the PM on the creation of the Council of Czech Competitiveness (CCC) formed by AmCham with the cooperation of other foreign business associations and presented him with a booklet outlining the CCC's main priorities and recommendations. Stacey emphasized that tax policy was the single most important issue for businesses when making employment and investment decisions. On behalf of the CCC, he urged the government to prepare a ten-year tax policy, to clamp down on the wide-spread tax evasion before raising the taxes of those businesses who are actually paying, and to create an effective tax modeling system. (Note: The complexity of tax policy is a particular concern of both international and domestic businesses in the Czech Republic. A recent study by the World Bank and PwC found that businesses must spend on average 614 hours to prepare their taxes compared to the EU average of just 232. End note.)

15. (SBU) Stacey also reported that the CCC believes that tourism has the potential to become a major pillar of the Czech economy. Government policy on tourism, however, is split between several different agencies creating duplication and waste. Most cultural events are also aimed at a local Czech audience rather than striving to bring in foreign

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tourists. Thus the CCC is recommending that the government consolidate tourism policy under one agency, create a five-year marketing plan, invest in convention tourism, concentrate on on-line promotions, review Czech visa policy and fund two major international cultural events a year.

16. (SBU) In regard to the Czech Republic's goal of transforming itself from an assembly line economy to a knowledge-based economy, Stacey noted that the CCC is recommending that the government focus its research funding on a few priority areas, actively recruit world class scholars in those priority areas, and create unique research opportunities. The Czech Republic is too small to try to do everything or to rely on its scientists alone. Stacey also urged the Czech government to separate grant-giving and grant-receiving agencies. Stacey also offered AmCham's assistance to help the government learn from the experiences of other countries such as the U.S. on how to sponsor greater university-business cooperation and the greater commercialization of research.

17. (SBU) Stacey noted that uncertainty about Czech intentions regarding the Euro made it difficult for businesses to plan long-term. Thus the CCC is urging the government to clearly announce its intent regarding Euro adoption and to establish a regularly updated timeline and plan toward Euro adoption. Stacey also noted that the Czech Republic has one of the worst energy intensity levels in the EU and urged the government to make energy efficiency a bigger priority.

18. (SBU) Stacey also noted that the large budget deficit and growing distrust in public officials should compel the government to become both more efficient and transparent. To this end, the CCC is recommending the government sign and implement EU conventions on good government conduct, follow the Slovak example regarding legislation designed to prevent the distortion of competition by public agencies, reduce the wide-spread use of no-bid contracts and eliminate the ability of government officials to hide their ownership in companies

competing for government contracts through the use of bearer shares. Finally Stacey, on behalf of the CCC, urged the government to increase training for judges on the new bankruptcy law, which was prepared with the help of AmCham and the Embassy.

Fischer: Electoral System Creates Weak Governments

¶9. (SBU) PM Fischer thanked AmCham for the critique and recommendations and expressed strong interest in continuing a dialog. He noted that his government is non-political and temporary and was limited in what it could do. He said it was unfortunate that his temporary government was unexpectedly entering its second six month period. It is much harder to plan for two six month periods rather than for one year. The Czech Republic also needs a strong government able to make the difficult political decisions. An interim government should have no place in the Czech Republic and it is unfortunate that the politicians have not recognized this.

He noted the extension of his government meant that it will now have to address some of the issues such as certain privatizations and legislation that it expected to leave to the politicians and for which, because of its non-political nature, it is ill prepared to tackle.

¶10. (SBU) PM Fischer noted that the political system in the Czech Republic is broken. It produces weak coalition governments, which have to compromise and are unable to enact needed reforms or take difficult decisions. He was not confident that the next election would change this, suggesting the likely outcome would be another weak coalition or a weak minority government. This in turn would create even more public disillusionment with politics. Thus he thought the Czech Republic should seriously consider changing its electoral system. He also complained of the large divide between politicians and civil servants. Partly as a vestige of the Communist era, civil servants are looked down upon in the Czech Republic as parasites feeding on taxpayer money. Politicians often appoint politicians to positions better suited to career civil servants and generally treat the civil service very poorly. As a result, civil servants bear a grudge against politicians. He also complained that the Czech political scene suffered from short term thinking that enabled difficult decisions and needed reforms to be constantly postponed.

Fischer on AmCham Critique

¶11. (SBU) Fischer noted that the perception of corruption was worst than the actual level of corruption, Nevertheless,

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Fischer announced that his government is planning to introduce a draft anti-corruption package by the end of the year, but cautioned that it is unclear how the political parties and the parliamentarians will receive it. He said he personally supported Euro adoption. The Czech Republic had made this commitment and should follow through. His government is trying to control the budget deficit to make Euro adoption possible in the near future. Nevertheless, in the current budget climate (the Czech budget deficit is expected to exceed 5 percent of GDP for the next several years) Euro adoption is only a distant dream. He cautioned, however, that Euro adoption is a political issue that will be determined by future governments, but agreed that they should clearly articulate their goals and plans.

¶12. (SBU) PM Fischer also agreed that tourism offered untapped potential and noted that visa policy toward the countries in the Western Balkans would be liberalized in December. He also agreed that the government should more energetically promote the transition to a knowledge economy. University reform needs to be concluded. It makes no sense for Ceske Budejovice to have two public universities, and all 28 Czech public universities do not need to be research universities. The Czech Republic also does not educate

people to manage universities and research programs. It is important to ensure that the government is funding research programs that are well-managed and competitive in Europe and globally and that the government is not just throwing money down a hole.

¶13. (SBU) PM Fischer also advocated programs like e-government and consolidating government spending. He said it makes no sense for each ministry to order cars and supplies separately. Many ministries could use their resources better. He questioned why the Czech Republic needs 14 regions, something he admitted he could not change but called for slimmer and more effective local government. On energy, he agreed on the need for greater energy efficiency and noted the desirability of further diversification of energy supplies and suppliers. On tax reform, he said it was a pity that the previous government fell before former Finance Minister Kalousek had completed his ambitious tax reforms and hoped that the next government would continue Kalousek's work.

Fischer on the Economy

¶14. (SBU) On the state of the economy, he noted that the Czech Republic had entered into the recession with two relative advantages. First, the global crisis did not hit the Czech financial system and thus the Czech Republic did not experience any significant problems with toxic assets or liquidity. Second, the crisis occurred after a period of very strong growth. He noted that the first victims of recession are always the forecasters and economic models. As late as November 2008, all international forecasters were still predicting that the Czech economy would grow by over two percent in 2009. Fischer said he was pleased that unemployment is still lower than he would have predicted. He cautioned, however, that history shows that in a recession the first to be hit is industry and businesses followed later by public finances and then households. Even though real GDP fell 5 percent in the first half of the year, household consumption increased. The recovery is following a similar path with first industry and businesses and then public finances and only then households showing improvement.

¶15. (SBU) Fischer noted that he was proud that the Czech Republic resisted calls to increase spending to stimulate public consumption. Instead the Czech Republic pursued a modest program designed to stimulate supply and employment. He also noted his pride that the Czech Republic had avoided protectionist policies. He added that the recently passed package of austerity measures designed to keep the ballooning budget deficit under control had been far from ideal but was a compromise agreed between the two main political parties. To that end it neither reflected Keynesian nor Freemanesque thinking. He also noted that he was reluctant to make predictions on next year but thought 1.5 percent growth was likely to be in the ball park.

Comment

¶16. (SBU) PM Fischer was extraordinarily open and frank about the limitations of his government and the Czech political scene. On economic issues it is clear that he is a free market, fiscal conservative, whose views more closely track with those of the Civil Democrats (ODS) and TOP 09 than those of the Social Democrats (CSSD). His honest, pragmatic,

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low-key approach, apparently devoid of personal ambitions, has given his government among the highest approval rating of any government in the Czech Republic's short history.
Thompson-Jones